Supreme Court, U.S.
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No. 15-145

IN THE

Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.

Petitioner,

v.

DANIEL LEE RITZ, JR.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY IN SUPPORT OF CERTIORARI

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

I. THE QUESTION PRESENTED IS IMPORTANT AND ARISES FREQUENTLY 1

II. RESPONDENT'S CLAIM THAT HE WILL PREVAIL ON ALTERNATIVE GROUNDS ON REMAND IS IRRELEVANT AND INCORRECT 6

III. THE DECISION BELOW IS WRONG 9

CONCLUSION 12

TABLE OF AUTHORITIES

Page(s)

CASES

Clark v. Rameker,
134 S. Ct. 2242 (2014) 2

Cohen v. de la Cruz,
523 U.S. 213 (1998) 5

Field v. Mans,
516 U.S. 59 (1995) 9, 10, 11

Harris v. Viegelahn,
135 S. Ct. 1829 (2015) 2

In re Lawson,
791 F.3d 214 (1st Cir. 2015) 3

Kawaauhau v. Geiger,
523 U.S. 57 (1998) 4, 8

McClellan v. Cantrell,
217 F.3d 890 (7th Cir. 2000) 3, 4, 11, 12

Pennsylvania Dep't of Pub. Welfare v. Davenport,
495 U.S. 552 (1990) 2

STATUTES

11 U.S.C. § 523(a) ..... *passim*

11 U.S.C. §§ 548-52 12

TABLE OF AUTHORITIES
(continued)

Page(s)

11 U.S.C. § 727(a)(2) 4, 5, 11

Texas Business Organizations Code § 24.005 7

OTHER AUTHORITIES

S. Ct. R. 10 2

Petitioner demonstrated that certiorari should be granted because this case presents a clean vehicle to resolve an acknowledged circuit split on an important issue that arises frequently in bankruptcy. Respondent admits that the circuits are divided, does not dispute that the issue has arisen in at least 17 reported cases in recent years, and does not attempt to identify any obstacle that would prevent the Court from deciding the Question Presented. To the contrary, he tacitly concedes that there is no such vehicle problem by going out of his way to explain why this case is a *better* vehicle than *In re Lawson*, No. 15-113, which is likely to go to conference in January. *See* Opp. 11, 26 ("[I]f the Court [is] inclined to resolve the question presented, it should do so in this Chapter 7 case, rather than the Chapter 13 context [of] *In re Lawson*.").

Respondent nonetheless contends that the Question Presented has not arisen frequently enough to merit review; that certiorari should be denied because he may yet prevail in a future remand on alternative grounds that the Fifth Circuit declined to consider below; and that the decision below is correct. All of these arguments are meritless. The petition should be granted.

I. THE QUESTION PRESENTED IS IMPORTANT AND ARISES FREQUENTLY

At every turn, Respondent acknowledges that "the petition correctly identifies a circuit split." Opp. 1; *see also id.* at 10, 12. His principal argument against certiorari is that this admitted split is "shallow" and that the issue does not arise with enough "real frequency" for this Court's review. Opp. 12-16.

First, contrary to Respondent's characterization, the 17 recent cases that Petitioner has identified are hardly just a "handful." Opp. 12. They reflect a 2-1 split at the circuit level, two cases before bankruptcy appellate panels in the Sixth and Tenth Circuits, and another dozen cases in bankruptcy courts across the country. *See* Pet. at 14-16 & nn. 2, 3. That more than satisfies the standards for certiorari. *See* S. Ct. R. 10.*

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* The Court has recently granted certiorari to address statutory questions arising far *less* frequently. *See, e.g.*, *Harris v. Viegelahn*, 135 S. Ct. 1829, 1836 (2015) (granting certiorari to resolve a 1-1 split on whether "undistributed postpetition wages 'are to be returned to the debtor'" after conversion of a case from chapter 13 to chapter 7); *Clark v. Rameker*, 134 S. Ct. 2242, 2246 (2014) (granting review to resolve a 1-1 split on whether "inherited IRAs" qualify as exempt "'retirement funds'" in chapter 7 bankruptcy); Brief in Opposition, *Baker Botts L.L.P. v. ASARCO LLC*, No. 14-103, 2014 WL 4075961 at *14 (5th Cir. 2014) (unsuccessfully opposing certiorari on the availability of attorney's fees for the cost of litigating a bankruptcy fee application, where there was only a "nascent split of just two courts of appeals" and there had been "few decisions" on the issue by any court); Brief in Opposition, *Pacific Operators Offshore, LLP v. Valladolid*, No. 10-507, 2011 WL 178699, at *14-15 (9th Cir. 2011) (unsuccessfully opposing certiorari on the workers-compensation provision of the Outer Continental Shelf Lands Act, even though the issue arose "rarely," and only "two cases presenting the question, over twenty years apart, ha[d] reached any [other] court of appeals"); Brief in Opposition, *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, No. 11-166, 2011 WL 5014752, at *13 (7th Cir. 2011) (unsuccessfully urging denial where there was a "shallow," "two-court conflict," with "few decisions addressing the issue"); *cf. Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 557 (1990) (noting grant of certiorari without even a circuit split "[t]o address a conflict *among Bankruptcy Courts*" on whether "state-imposed criminal restitution obligations can[] be discharged in a Chapter 13 bankruptcy" (emphasis added)).

Moreover, the Question Presented is important even apart from how often it arises. As the First Circuit recognized, whether debtors should be allowed to subvert the equitable purposes of the Bankruptcy Code to escape liability for intentional fraud is inherently a "significant issue" of public importance. *In re Lawson*, 791 F.3d 214, 216 (1st Cir. 2015). And as the Seventh Circuit explained, the rule adopted by the Fifth Circuit threatens to encourage wrongful conduct and transform individual bankruptcy into an "engine for fraud." Pet. at 13-14 (quoting *McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000)).

Second, Respondent attempts to minimize the significance of the Question Presented by asserting that "most frauds do involve misrepresentation." Opp. 12. He provides no evidence for that claim, and even if true, it would not show that the Question Presented is unimportant: Whatever form *most* fraud might take, there are *many* instances of fraud without any misrepresentation, as evidenced by the examples Petitioner has identified. And now that the Fifth Circuit has given debtors a green light to get away with such fraud, it is certain to become even *less* rare unless this Court steps in.

Third, Respondent argues that the Fifth Circuit's decision should be allowed to stand because other provisions of the Bankruptcy Code will protect against deliberate fraudulent-transfer schemes. He relies mainly on Section 523(a)(6), but "willful and malicious injury" under that provision is narrower than "actual fraud" under Section 523(a)(2). While "actual fraud" requires only a showing of intent to benefit oneself through a fraudulent scheme, the

"willful and malicious" standard of Section 523(a)(6) requires a higher showing of "actual intent to cause injury" to the victim. *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998) (emphasis added). Respondent's contrary view that Section 523(a)(6) encompasses *all* instances of intentional fraud makes little sense because it would render superfluous the specific provision for "actual fraud" under Section 523(a)(2)(A). *Cf. Kawaahau*, 523 U.S. at 61-62 (cautioning that "willful and malicious injury" under Section 523(a)(6) should not be read so broadly as to "obviate the need for" other specific provisions of Section 523(a)).

Respondent also points to Section 727(a)(2)(A), which imposes an absolute bar to discharge against anyone who has fraudulently *transferred away* assets within "one year" before filing for bankruptcy. Opp. 13. But Respondent recognizes that this provision will be of no help where someone wrongfully *obtains* money through a fraudulent-transfer scheme and then seeks to evade liability through bankruptcy. As Respondent admits, this is the typical "fact pattern" that has played out not only in this case but also in *McClellan* and *Lawson*. *See id.* at 13, 20.

Respondent next suggests that fraudulent-conveyance statutes will solve the problem because they generally require fraudulently transferred assets to be "returned." Opp. 21. That is cold comfort because the assets have typically been dissipated by the time of bankruptcy, leaving no direct avenue of recovery for the creditor. Once again, that perfectly describes *McClellan*, *Lawson*, and this case. Accordingly, the only way to secure a just result is to bar the debtor from discharging the debt for the

money he fraudulently obtained, which the decision below makes impossible.

Finally, Respondent acknowledges that both Section 523(a)(6) and 727(a)(2) typically have *no application whatsoever* in Chapter 13 cases, where creditors will thus be left defenseless against the type of fraud at issue here if they cannot invoke Section 523(a)(2)(A). *See* Opp. 23. Respondent tries to spin this in his favor by claiming that Congress "inten[ded]" to "encourage [the] use of" Chapter 13 by "expanding the scope of [] discharge" to *affirmatively authorize* the discharge of debts for money wrongfully obtained through fraudulent means. *Id.* That is an implausible account of congressional intent, to say the least. Congress "has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an '*honest* but unfortunate debtor.'" *Cohen v. de la Cruz*, 523 U.S. 213, 217 (1998) (emphasis added). Congress may have wished to encourage the use of Chapter 13 instead of Chapter 7, but it would not have done so by rewarding *intentional fraud* as part of the bargain.

In short, there is no merit to Respondent's argument that the type of deliberate fraudulent-transfer scheme at issue here arises infrequently or can be adequately addressed by other provisions of the Bankruptcy Code. This case therefore presents an important question that warrants this Court's immediate review.

II. RESPONDENT'S CLAIM THAT HE WILL PREVAIL ON ALTERNATIVE GROUNDS ON REMAND IS IRRELEVANT AND INCORRECT

Respondent suggests that review should be denied because even if he loses on the Question Presented, he will prevail on remand on other grounds. That speculation provides no basis for denying review. Indeed, it is hard to take Respondent's argument seriously when he also contends that the same record on which he believes he will prevail on remand is a "*virtue*" that makes this case a *better* vehicle than *Lawson*. Opp. 26-27 (emphasis added). In any event, Respondent's optimism about his chances of prevailing on remand is misplaced.

1. Ignoring the theory of Petitioner's complaint, on which the Fifth Circuit based its decision as a matter of law, Respondent claims that Petitioner "failed to prove" that Respondent actually had fraudulent intent in carrying out his scheme. Opp. 24-27 From this, Respondent argues that this case "does not actually present the question that petitioner has posed," Opp. 14-15, and that granting review will not affect the outcome of the case, Opp. 24-27

As Respondent acknowledges, however, the Fifth Circuit "saw no need to reach" the factual issue of whether Respondent actually carried out his scheme with fraudulent intent, and thus "declined to address" it. Opp. 9, 24. Instead, the court held that *even if* Respondent acted with fraudulent intent as alleged, he did not commit "actual fraud" because he is not alleged to have made any *misrepresentation*. The correctness of that holding is squarely presented here.

Speculation that the Fifth Circuit might reach the same result on the basis of an alternative factual finding that it refused to make in the decision below is no reason to deny certiorari.

Indeed, Respondent's liability on remand will likely be a foregone conclusion if this Court reverses and holds that "actual fraud" can be based on fraudulent intent without any misrepresentation. Otherwise the Fifth Circuit would have had no reason to engage in a lengthy analysis—and to create an avowed circuit split—about whether the "actual fraud" bar can apply where there is fraudulent intent but no misrepresentation. If, as Respondent suggests, he did not commit "actual fraud" under any standard, it would have been far easier for the Fifth Circuit to so hold.

Moreover, while the Fifth Circuit did not reach the question, the district court found that Respondent acted "*for the purpose* of perpetrating . . . an actual fraud . . primarily for [his] direct personal benefit," when he "drained Chrysalis of funds and fraudulently transferred those funds to other entities under his control and/or ownership." Pet. App. 67a, 69a (emphasis added). That finding of actual fraudulent intent was necessary to the district court's holding that Respondent is personally liable to Petitioner under Texas Business Organizations Code § 24.005, which applies only in cases involving "actual intent to hinder, delay, or defraud" a creditor. Pet. App. 71a. Even Respondent does not dispute this point, conceding that "the District Court *did* suggest that the evidence was sufficient to demonstrate 'intent to commit actual fraud.'" Opp. at 14 n.3 (emphasis added). That same evidence of fraudulent

intent is likely to control the outcome of this case on remand.

2. Respondent further claims that he could not have committed "actual fraud" under Section 523(a)(2)(A) because the courts below found that he did not inflict any "willful and malicious injury" under Section 523(a)(6). *See* Opp. at 26. That argument fails for two reasons.

First, the lower courts' ruling on the Section 523(a)(6) issue was based on *procedural* grounds: "[Petitioner's] complaint ma[de] [only] a glancing reference to [Section 523(a)(6)]," which was "not enough to preserve a claim under this provision." Pet. App. 75a, 96a. And even if that claim had been properly alleged in the complaint, it was not developed: "no exhibits were introduced, no testimony was adduced, and no briefing was done relating to § 523(a)(6)." *Id.* That failure was particularly important in the Fifth Circuit's view because Fifth Circuit law requires "*explicit evidence*" to prove "willful and malicious injury" under Section 523(a)(6). Pet. App. 18a (citation omitted; emphasis added by Fifth Circuit). Petitioner faces no such procedural obstacles to proving "actual fraud" under Section 523(a)(2), which was the central focus of the litigation in all three courts below.

Second, as explained above, it makes perfect sense to say that a debtor committed "actual fraud" without inflicting any "willful and malicious injury," because the latter requires a higher showing of "actual intent to cause injury" to the victim. *Supra* p.4 (quoting *Kawaauhau*, 523 U.S. at 61). It is thus consistent to say, as the district court found here, that Respondent

engaged in actual fraud "for the purpose of . . . personal benefit," even though he may not have maliciously intended to cause injury as required under Section 523(a)(6). Pet. App. 68-69a, 72a. If anything, this aspect of the factual record only underscores why this case is a better vehicle than *Lawson*, where no factfinding has yet occurred. The district court's finding here that Respondent's scheme was driven by "fraudulent intent" virtually guarantees that the resolution of the Question Presented will determine whether he gets away with it. Pet. App. 69a.

3. Finally, Respondent contends that he may also prevail on remand on two other arguments that the Fifth Circuit declined to address—that he should not have been held personally liable under Texas law for the debt to Petitioner, and that the trial court erred in finding that his fraudulent transfers were not made for reasonably equivalent value. *See* Opp. 25. But because the Fifth Circuit did not reach either of these issues, they do not provide any basis for denying certiorari. This Court can and should grant review to resolve the Question Presented, and leave these separate issues to be addressed on remand if necessary.

III. THE DECISION BELOW IS WRONG

Petitioner demonstrated that for the past century at least, the common law has consistently used the term "actual fraud" to refer to deliberate fraudulent-transfer schemes. Accordingly, such schemes clearly fall under the category of "actual fraud" in Section 523(a)(2)(A), which is a "term of art[]" that "the common law has defined." *Field v. Mans*, 516 U.S. 59,

69 (1995). By that simple logic, Section 523(a)(2)(A) bars Respondent from discharging the debt that he owes to Petitioner for the money that he obtained by fraudulent means. *See* Pet. 16-18. Respondent tries but fails to resist that conclusion.

First, Respondent does not mention, much less refute, Petitioner's evidence that the common-law meaning of "actual fraud" has long encompassed deliberate fraudulent-transfer schemes. Instead, Respondent relies primarily on this Court's decision in *Field*, which considered the scope of "actual fraud" *in a case of alleged fraud by misrepresentation. See* Opp. at 17-18. As Petitioner has explained, however, *Field* had no reason to consider whether "actual fraud" might also include *other* types of fraud that do not involve misrepresentation. All parties agreed that there *was* a misrepresentation in that case, and the only question was what "level of reliance" a creditor must prove *when alleging that type of fraud. Field*, 516 U.S. at 63; *see* Pet at 18-19. Respondent has no answer to this point, so he tries to change the subject: He resorts to cherry-picking quotes from a scattering of treatises that address actual fraud in the context of misrepresentation, but nowhere does he attempt to establish that these definitions are *exclusive* of other common-law meanings. Nor does he attempt to engage with the many instances Petitioner has identified of the long-established usage of "actual fraud" to encompass deliberate fraudulent-transfer schemes. *See* Pet 16-18.

Second, Respondent argues that the statute's reference to money "obtained by" fraud somehow helps support his interpretation. He bases that claim on *Field*, where money had allegedly been obtained

by fraudulent misrepresentation, and the Court held that "some degree of reliance is required to satisfy the element of causation inherent in the phrase 'obtained by.'" Opp. 18 (quoting *Field*, 516 U.S. at 66). Once again, however, that says nothing about how the statute applies in *other* situations, where money is "obtained by" *other* fraudulent means that do *not* involve misrepresentation. Here, for example, the money that Respondent obtained through his fraudulent-transfer scheme was "obtained by" fraudulent means despite the absence of any misrepresentation or reliance.

Third, Respondent makes the same mistake by asserting that obtaining money "by" fraud must always involve "induc[ing] the creditor to part with his money or property." Opp. 19 (quoting *McClellan*, 217 F.3d at 896 (Ripple, J., concurring)). That is incorrect. In fact, the statute contains no requirement that the money or property be obtained *from* the creditor. Instead, Section 523(a)(2)(A) refers generally to any money or property that is "obtained *by*" actual fraud. That describes the situation here, where Respondent obtained money through a deliberate fraudulent-transfer scheme, just like the fraudsters in *Lawson* and *McClellan*.

Finally, Respondent's remaining arguments on the merits simply recapitulate his claim that, even without Section 523(a)(2)(A), other legal provisions will solve the problem of debtors using bankruptcy to escape liability after enriching themselves through deliberate fraudulent-transfer schemes. Opp. 21-23. Petitioner has already shown that this is wrong. *See supra* pp.4-5 (discussing Sections 523(a)(6) and 727(a)(2) of the Bankruptcy Code, as well as generic

fraudulent-transfer statutes such as 11 U.S.C. §§ 548-52). Accordingly, the simple reality is that if the Fifth Circuit's decision is allowed to stand, the Bankruptcy Code will leave creditors with no protection against unscrupulous actors who seek to enrich themselves through fraudulent schemes like the ones in this case, *McClellan*, and *Lawson*.

CONCLUSION

For the foregoing reasons, the petition for certiorari should be granted.

Respectfully submitted,

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